SUPREME COURT, U. S.

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No. 385

# Supreme Court of the United States

OCTOBER TERM, 1965

ESTATE OF HARRY STOLL LEYMAN, Deceased,
HARRY S. LEYMAN, JR., Executor, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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# Supreme Court of the United States

OCTOBER TERM, 1965

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No.

ESTATE OF HARRY STOLL LEYMAN, Deceased,
HARRY S. LEYMAN, JR., Executor, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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Petitioner, Estate of Harry Stoll Leyman, Deceased, Harry S. Leyman, Jr., Executor, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in its case No. 15,653.

### OPINIONS BELOW

The opinion of the Tax Court is reported at 40 T.C. 100 and is printed at page 192a of the Appendix to Brief for Petitioner, Volume I.[1] The opinion of the court of appeals is reported at 344 F. 2d 763 and appears at Appendix A hereto, page 1a, *infra.*

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[1] Nine copies of the Appendices printed for use in the court of appeals have been filed with the Clerk of this Court pursuant to Rule 21(4).

## JURISDICTION

The judgment of the court of appeals in its case No. 15,653 was entered on March 29, 1965. Appendix B hereto, page 14a, *infra*. Its judgment in No. 15,732, a cross appeal decided on the same record from the Tax Court, also was entered on March 29, 1965. Appendix C hereto, page 15a, *infra*. Petitioner's timely application for rehearing in No. 15,653 was denied on April 27, 1965. Appendix D hereto, page 16a, *infra*. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## QUESTION PRESENTED

Petitioner timely filed a federal estate tax return showing tax due of some $2 million and timely paid that amount. The total tax due, as subsequently determined, was approximately $3.2 million. The question presented is whether petitioner must pay a civil fraud penalty of 50 percent of the total tax due, $3.2 million, as the court of appeals held, or 50 percent of the additional tax due, $1.2 million, which takes into account the fact that petitioner timely reported and paid $2 million of tax.

## STATUTE INVOLVED

Section 3612(d)(2) of the Internal Revenue Code of 1939:

> "FRAUD.—In case a false or fraudulent return or list is willfully made, the Commissioner shall add to the tax 50 per centum of its amount." 53 Stat. 438.

## STATEMENT

Harry Stoll Leyman died on May 24, 1954. The federal estate tax return for his estate, showing tax due

of approximately $2 million, was timely filed and the tax shown on the return was paid.[2]

The Tax Court found that additional estate tax of approximately $1.2 million was due and that the executor had filed a false and fraudulent return. Under section 3612(d)(2) of the Internal Revenue Code of 1939, the Tax Court held the estate liable for a penalty of 50 percent of the additional tax due. On cross appeals, the Court of Appeals for the Sixth Circuit disagreed as a matter of law with the Tax Court's determination of the amount of the fraud penalty. The 50 percent penalty, the court below held, is to apply not merely to the $1.2 million of additional tax due, but to the total tax due of $3.2 million (the sum of the additional tax due and the tax properly reported and paid).[3]

## REASONS FOR GRANTING THE WRIT

1. In this case, the Government has taken the position, rejected by this Court in *Commissioner* v. *Acker*, 361 U.S. 87 (1959), that the penalty provisions of the Internal Revenue Code of 1939 are to be broadly construed. The decision below, upholding the Government's position and reversing the Tax Court, thus is inconsistent with the rule enunciated in *Acker* that "'penal statutes are to be construed strictly' . . . and that one 'is not to be subjected to a penalty unless the words of the statute plainly impose it.'" 361 U.S. at 91. This principle is of the highest importance in the

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[2] The tax reported and paid with the return on July 21, 1955 amounted to $2,046,158.28. On August 18, 1955, tax of $10,313.63 was paid after discovery of a mathematical error in the return. Appendix to Brief for Petitioner, Volume I, p. 18a.

[3] The amount of the penalty, therefore, was not $620,121.08 as computed by the Tax Court (50 percent of $1,240,242.15), but $1,648,357.03 (50 percent of $3,296,714.06).

administration of the internal revenue laws, whose penal provisions, comparable in significant respects to criminal statutes but administered for the most part without the safeguards of criminal procedures, potentially impinge upon a large proportion of the citizenry. Thus, the question posed by the court of appeals' decision remains an important one even though it arises in the construction of a provision of the Internal Revenue Code of 1939.

Section 3612(d)(2) of the Code is the penal statute in issue here. In prescribing the penalty for filing a false or fraudulent estate tax return, it provides that "the Commissioner shall add to the tax 50 per centum of its amount." The precise issue is thus the meaning of the phrase "the tax." The phrase can sensibly be read to mean the additional tax due, which would make the penalty relate to the amount of tax not reported as due on a fraudulently filed return. Read to mean the total tax due, it would have the bizarre consequence of making the fraud penalty in the case of a $2 million estate tax the same—$1 million—regardless of whether the total tax due is understated by $100 or $2 million.

The court of appeals nevertheless adopted the latter reading upon the Government's urging. In doing so, it has decided an important federal question in a way that conflicts with applicable decisions of this Court.

*Commissioner* v. *Acker, supra,* involved an effort by the Government to have applied as expansively and harshly as ambiguous wording would permit section 294(d) of the Internal Revenue Code of 1939. The question was whether the failure of a taxpayer in specified circumstances to file a declaration of estimated tax subjected him both to the penalty for failing to file a declaration and to the penalty for filing a sub-

stantial underestimate of tax. Despite significant passages in legislative history that supported the Government's position, this Court held that only the penalty for failing to file a declaration was applicable, using the language we have quoted above and citing *FCC* v. *American Broadcasting Co.*, 347 U.S. 284, 296 (1954); *Keppel* v. *Tiffin Savings Bank*, 197 U.S. 356, 362 (1905); *Tiffany* v. *National Bank of Missouri*, 18 Wall. 409, 410 (1874); *Elliott* v. *Railroad Co.*, 99 U.S. 573, 576 (1879).

The rule thus reaffirmed in the *Acker* case is, as we have said, that "one 'is not to be subjected to a penalty unless the words of the statute plainly impose it.'" In this case, as in *Acker*, the words of the statute do not "plainly impose" the harsh penalty for which the Government contends.

Certainly the Congress that rewrote the Internal Revenue Code in 1954 did not believe that the words of the statute it was revising plainly imposed, in section 3612(d)(2), a penalty measured by the total tax due. Quite the contrary. As a substitute for section 3612(d)(2) and other fraud penalty provisions of the 1939 Code, Congress enacted section 6653(b) of the 1954 Code, which makes clear beyond argument that the fraud penalty for all internal revenue taxes is 50 percent of the additional tax due ("underpayment" in the language of the statute). In commenting on this section, the tax-writing committees stated unmistakably their view that it was a re-enactment of existing law so far as estate taxes were concerned. "Existing law imposes a 50 percent addition in the case of fraud applicable to all taxes, but, in the case of taxes other than income, estate, and gift, that addition is based on the total amount of tax imposed." H.R. Rep. No.

1337, 83d Cong., 2d Sess. A-419 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 591 (1954). The expert staff of the Joint Congressional Committee on Taxation expressed the same understanding in its summary of the bill that became the Internal Revenue Code of 1954. *Hearings Before the Senate Finance Committee on H.R. 8300,* 83d Cong., 2d Sess. (Part 1) 85 (1954).[4]

Proof that the words of the statute do not "plainly impose" a penalty measured by the total tax due is provided by the opinion of the court below. It did not attempt to rely upon the statutory language as conveying a single unambiguous meaning but purported instead to find in history the solution to the problem of construing the statutory words. History, however, even if clear, is an insufficient justification for the imposition of a penalty where " 'the words of the statute [do not] plainly impose it.' " Thus, in *Acker,* this Court narrowly construed a penalty provision of the 1939 Code even though the congressional committee reports and the Government's own long-standing regulation supported an expansive interpretation, and despite the fact that Congress, with knowledge of the regulation, several times amended the 1939 Code but left the relevant provision unchanged. Furthermore, in this case, unlike *Acker,* the "history" as well as the statutory language is unclear.

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[4] Petitioner relies on these 1954 reports not to establish the intent of the Congress which enacted section 3612(d)(2) of the 1939 Code or the predecessor provisions from which section 3612 (d)(2) was derived, but to demonstrate that the language of the section is not sufficiently clear, within the meaning of *Acker,* to justify the Government's interpretation. Indeed, it is unthinkable that all three congressional committees would have concluded that section 3612(d)(2) provides for a penalty measured by the additional tax due if "the words of the statute plainly impose[d]" a penalty based on the total tax due.

When section 3176 of the Revised Statutes, from which section 3612(d)(2) is derived, was in effect, the Commissioner of Internal Revenue ruled in 1899 that the penalty "is always computed upon the amount actually due over and above that shown to be due by the false return." T.D. 21517, 2 Treasury Decisions, Internal Revenue 281 (1899). In 1915 a successor Commissioner revoked the 1899 ruling and held that the penalty "applies to the full amount of the tax involved." T.D. 2266, 17 Treasury Decisions, Internal Revenue 263 (1915). Like the administrators of the statute, commentators are in disagreement with one another as to the base on which the estate tax fraud penalty is computed under the 1939 Code. Compare the treatises cited by the court below, 344 F. 2d at 769 n. 29, p. 12a n. 29, *infra,* with those cited by the Tax Court, 40 T.C. at 125-26 & n. 10, Appendix to Brief for Petitioner, Volume I, pp. 232a-33a & n. 10.

The extended recitation by the court below of the separate origins of the estate and income taxes merely explains the historical development of those taxes; it does not clarify the inherent ambiguity of the phrase "the tax." The court of appeals' reliance on the fact that section 293(b) of the 1939 Code imposes an income tax fraud penalty of 50 percent of "the deficiency," while section 3612(d)(2) imposes an estate tax fraud penalty of 50 percent of "the tax," is completely misplaced. While the difference in language between the two sections is explained by history, as detailed in the margin,[5] that history does not support the difference in result found by the court below.

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[5] The term "deficiency" did not appear in any of the federal tax laws until 1918. Prior to 1918, section 3176 of the Revised Statutes, the predecessor of section 3612(d), was a general penalty provision applicable to all federal taxes, *direct and indirect,* in-

The court of appeals found no helpful judicial precedent dealing with the construction of section 3612(d)(2) and so turned to section 3612(d)(1) which is similarly derived from section 3176 of the Revised Statutes. Section 3612(d)(1) provides in pertinent part that, "In case of any failure to make and file a return or list within the time prescribed by law, . . . the Commissioner shall add to the tax 25 per centum of its amount . . . ." As to this provision, the court below stated:

> "The words ["the tax"] obviously refer to the whole tax, there being no deficiency less than the whole." 344 F. 2d at 769, pp. 12a-13a, *infra.*

The authority cited for the quoted statement is *American Milk Products Corp.* v. *United States,* 41 F. 2d 966 (Ct. Cl. 1930), in which the Court of Claims did hold that "the tax" in the non-filing penalty provision of section 3176 of the Revised Statutes meant the total

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cluding the income tax from 1913 through 1918. During the pre-1918 period, as evidenced by the conflicting opinions of the Commissioners in 1899 and 1915, see p. 7, *supra,* the meaning of the phrase "the tax" in section 3176 was unclear. The fact that Congress in 1918 introduced the deficiency concept into the income tax law and chose at the same time to substitute a specific income tax fraud penalty, based on "the deficiency" (Revenue Act of 1918, section 250(b), 40 Stat. 1083), for the previously applicable general penalty of section 3176, did not in any way clarify or affect the phrase "the tax" in section 3176, which remained in effect for estate tax purposes. Indeed, until 1924, the deficiency concept was not even included in the estate tax law, and when it finally was made applicable (Revenue Act of 1924, sections 307, 308, 43 Stat. 308), Congress did not provide, as it had with the income tax, a new specific estate tax fraud penalty, but chose instead to have section 3176 continue in force. The difference in language between section 293(b) (derived from section 250(b) of the 1918 Revenue Act) and section 3612(d)(2) (derived from section 3176) of the 1939 Code thus is perfectly understandable and does not in any way support a difference in result.

tax due. But the Board of Tax Appeals held the contrary in *M. Cohn & Sons Co.*, 9 B.T.A. 87 (1927), not cited by the court of appeals, where the taxpayer had timely filed a return in accordance with the Revenue Act of 1917 but had failed to file a second return required for the same fiscal year under the Revenue Act of 1918. Since section 335(a) of the 1918 Act, 40 Stat. 1095, provided for a credit of the tax due under the 1917 Act, the taxpayer urged that "the tax" in section 3176 meant only the additional tax due under the 1918 Act and not the total tax due under that Act. In holding that the 25 percent addition applied only to the additional tax due, the Board of Tax Appeals stated:

> "The above quoted section 3176 of the Revised Statutes as amended by the Revenue Act of 1918 provides that a 25 per cent delinquency penalty be added to 'the tax,' for failure to file the required return. However, that term 'the tax' is not clear and unequivocal for sections 205(a) and 335(a) in providing a method for computing 'the tax' also provide for a credit, of the tax under the 1917 Act for the same fiscal year, towards the payment of the tax imposed by the 1918 Act. The question arises, does 'the tax' as used in section 3176 of the Revised Statutes as amended by section 1317 of the Revenue Act of 1918, mean the total tax as computed under that Act, or does it mean the said total tax less the credit provided for? Under such circumstances the statute is to be construed most strongly against the Government and in favor of the citizen." 9 B.T.A. at 92-93.

Thus, prior to the enactment of the 1939 Code, the only two courts that had construed the phrase "the tax" as it was used in section 3176 of the Revised Statutes reached opposite conclusions.

Further evidence that even under an "historical" approach, the phrase "the tax" is unclear, is provided by the determination of the Internal Revenue Service in Revenue Ruling 54-427, 1954-2 Cum. Bull. 42, also relating to section 3612(d)(1), which states in pertinent part:

> "Section 6651(b) [of the 1954 Code] is a new provision and expressly provides that for purposes of computing the delinquency penalty, the amount of the tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed upon the return. *The effect of this section is to provide specific statutory authority for the existing administrative rule whereby the delinquency penalty is computed on the net amount of tax due on the return rather than on the gross amount of tax required to be shown on the return.*" (Emphasis supplied.) 1954-2 Cum. Bull. at 43.

While Revenue Ruling 54-427 was not followed by the Tax Court in *West Virginia Steel Corp.*, 34 T.C. 851 (1960), it apparently was the view of the Internal Revenue Service in 1954 that the rule statutorily prescribed in section 6651(b) of the 1954 Code, that the phrase "the tax" means only the additional tax due, had been administratively in force under section 3612(d)(1) of the 1939 Code.

The final defect in the "historical" approach purportedly followed by the court of appeals was its failure to recognize that the phrase "the tax" appears also in section 3612(e) of the statute, which, of course, immediately succeeds section 3612(d). And, in section 3612(e), it is clear that "the tax" means only the addi-

tional tax due and not the total tax due as found by the court of appeals. That section, also derived from section 3176 of the Revised Statutes, provides in part that the fraud penalty ". . . shall be collected at the same time and in the same manner and as a part of *the tax* . . .:" (Emphasis supplied.) If "the tax" means the additional tax due, as urged by petitioner, section 3612(e) makes sense because the fraud penalty can be collected "at the same time and in the same manner and as a part of" the additional tax due. On the other hand, if "the tax" is construed to mean the additional tax due plus the tax previously reported and paid, as contended by the Government and held by the court of appeals, section 3612(e) is meaningless. The fraud penalty cannot be collected "at the same time" as both the additional tax due and the tax previously reported and paid because they are collected at two different times. Similarly, the additional tax due and the tax previously reported and paid are not collected "in the same manner." The latter is collected by what is colloquially referred to as "self-assessment"; the former (and any fraud penalty) after proceedings initiated by the Internal Revenue Service. Finally, as a matter of fact, the fraud penalty is collected "as a part" of the additional tax due and not as a part of the total tax due, which is paid in two different parts.

In sum, the Government takes the position that section 3612(d)(2) requires the exaction of a harsh and irrational penalty, a penalty based on the sum of the additional tax due and the tax timely reported and paid, despite the inherent ambiguity of the statutory language itself, the decisions of the Tax Court in this case and the Board of Tax Appeals in *Cohn, supra,* the ruling of the Internal Revenue Service in Rev. Rul. 54-

427, *supra,* the obvious meaning of "the tax" in section 3612(e), the initial interpretation of "the tax" by the Commissioner in T.D. 21517, *supra,* the contrary opinions of the commentators and the understanding of the House Ways and Means Committee, the Senate Finance Committee and the staff of the Joint Congressional Committee on Taxation. In these circumstances the Government's position cannot be squared with the *Acker* case because the words of section 3612 (d)(2) cannot be read as plainly imposing the penalty for which the Government contends. The court of appeals' decision, therefore, is in conflict with the controlling decisions of this Court—*Acker* and the cases on which the Court relied in *Acker.*

2. In addition to departing from this Court's decision in the *Acker* case, the court of appeals failed even to mention the extraordinary and clearly unintended practical consequences of its construction of section 3612(d)(2). Under its interpretation, the amount of the fraud penalty in this case would be the same whether the executor had reported no tax due with the estate tax return or $3.2 million of tax due. Moreover, under the decision of the court of appeals, one estate for which the total tax due is understated by a very small amount on a fraudulently filed return may be liable for a fraud penalty many times greater than that imposed on another estate for which the total tax due is understated by a very substantial amount. Finally, there is nothing in the opinion of the court of appeals, or in any congressional committee report from 1918, when the term "deficiency" first appeared in the income tax law, through 1939, when the 1939 Code was enacted, that even remotely suggests that there is any

policy reason for treating estate tax fraud differently from income tax fraud.[6]

This Court has reiterated time and time again, *e.g.*, *United States* v. *Gilmore*, 372 U.S. 39, 48 (1963), *NLRB* v. *Lion Oil Co.*, 352 U.S. 282, 288 (1957), that statutes are not to be interpreted in a manner that produces incongruous, irrational and capricious results. Indeed, it was precisely for this reason that the Board of Tax Appeals in the *Cohn* case, *supra*, rejected the Government's interpretation of "the tax" in section 3176 of the Revised Statutes:

> "Statutes should receive a sensible construction, such as will effectuate the legislative intention, and avoid, if possible an unjust or absurd construction.
>
> "See also *In re Chapman*, 166 U.S. 661.
>
> "The unstrained, natural and just conclusion to be reached upon the reading of the above quoted sections of the Revenue Act of 1918 is that the amount of tax paid under the 1917 Act should be credited against the amount found due for the

[6] The Government undoubtedly will rely on the following committee reports: S. Rep. No. 617, 65th Cong., 3d Sess. 18 (1918), 1939-1 Cum. Bull. (Part 2) 117, 130; H. Conf. Rep. No. 1037, 65th Cong., 3d Sess. 61, 91 (1919), 1939-1 Cum. Bull. (Part 2) 130, 144, 166; H.R. Rep. No. 708, 72d Cong., 1st Sess. 27, 30 (1932), 1939-1 Cum. Bull. (Part 2) 457, 476, 478; S. Rep. No. 665, 72d Cong., 1st Sess. 39, 42 (1932), 1939-1 Cum. Bull. (Part 2) 496, 524, 526. These reports show that the Congresses which enacted the Revenue Acts of 1918 and 1932 were aware that "the tax" related to estate tax fraud and "the deficiency" to income tax fraud. They show also that the Congresses were careful to avoid a duplication or doubling up of penalties. They do not show, however, that either of the Congresses intended to treat estate and income tax fraud differently, or that there is a reason for treating them differently. See note 5, *supra*.

same fiscal year under the 1918 Act and that if there be a balance due or a deficiency under the 1918 Act then the delinquency penalty should attach to such deficiency. *We do not believe that Congress ever intended to penalize a taxpayer for taxes duly paid upon a return made under an existing law.*" (Emphasis supplied.) 9 B.T.A. at 93.

## CONCLUSION

For the foregoing reasons, petitioner prays that a writ of certiorari issue to review the decision of the Court of Appeals for the Sixth Circuit and suggests that, since that decision is patently in conflict with the principle declared in *Acker*, summary reversal would be appropriate.

Respectfully submitted,

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July, 1965

# APPENDIX

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## APPENDIX A

Nos. 15653 and 15732

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 15653

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

ESTATE OF HARRY STOLL LEYMAN, Deceased, HARRY S. LEYMAN, JR., Executor, *Respondent*.

No. 15732

ESTATE OF HARRY STOLL LEYMAN, Deceased, HARRY S. LEYMAN, JR., Executor, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for Review of Decision of the Tax Court of the United States.

Decided March 29, 1965

Before PHILLIPS and EDWARDS, Circuit Judges, and PRETTYMAN, Senior Circuit Judge.*

PRETTYMAN, Senior Circuit Judge: These are petitions to review a decision of the Tax Court of the United States, which held fraud in an estate tax case and adjudged additional taxes and fraud penalties to be due. Decedent was a business man of wide interests. His executor is his son. The estate tax return was timely filed and showed a tax due in the sum of $2,046,158.28, which was paid in full. As the result of a mathematical error on the return, an additional tax of $10,313.63 was paid by the estate a month after the return was filed. The tax Court found defi-

* Sitting by designation from the District of Columbia Circuit.

ciencies in tax of $1,240,242.15 and additions to tax (*i.e.*, penalties) of $620,121.08. Both the Commissioner of Internal Revenue and the executor of the estate filed petitions for review in this court. They are consolidated for purposes of argument and decision.

In brief, the executor contends (1) that the Commissioner failed to establish fraud by clear and convincing evidence, (2) that the Tax Court erred in admitting in evidence proof of the fact that the executor was convicted of fraud in this matter upon a plea of *nolo contendere*, and (3) that the Tax Court erred in including in the gross estate a certain $15,000 in municipal bonds. The Commissioner contends the opposite to each of the foregoing points and further contends that the Tax Court erred in fixing the fraud penalty at 50 per cent of the deficiency in tax instead of at 50 per cent of the total estate tax.

## I

The first problem is whether the Tax Court was clearly erroneous in its conclusion in respect to $613,314.52 cash. It found the Commissioner had established by clear and convincing evidence that the executor knowingly and willfully omitted these funds from the estate tax return, intending thereby to evade an estate tax due. We have little difficulty in agreeing with the Tax Court.

Decedent died on May 24, 1954, being then 82 years of age. He and his family of one son and three daughters owned, *inter alia*, the outstanding stock in a corporation known as Leyman Corporation, which in turn owned a portfolio of securities, extensive real estate, and certain subsidiaries which operated automobile sales agencies. The family had other business interests. The son was forty years old at the time of his father's death. For many years he had been an active participant in the family's affairs, having been second in line of command in many of them. When the father died, the son became the operating head

of these companies. His father's private secretary became his private secretary. He had been in constant touch with his father for several years prior to the latter's death, had power to sign checks on his personal account, went often with him on financial errands, etc.

The Leyman Corporation had a safe deposit box on rent in a bank. It was a large combination box, behind one door of which were five separate drawers, one of which was substantially filled with currency, totaling $613,314.52. The decedent's son, the executor, first saw currency in this box in 1943 or 1944, some ten years before his father's death. In December, 1953, some months before his death, decedent took some bonds (about $120,000) from a box in his room at home, gave them to his son, and told him to sell them and put a certain part of the proceeds in this corporate safe deposit box. Upon the trial of this case it was stipulated that the cash in the box belonged to decedent.

The executor did not include any of the cash in the box in the estate tax return. He said he thought the cash belonged to the corporation. In response to this claim the Commissioner pointed out (1) that the executor, as a director and officer of the corporation, saw its balance sheets and other financial statements and knew that no such item of cash appeared in them, and (2) that the corporation several times borrowed cash from banks for corporate purposes, which needs could easily have been met by recourse to the sums in the lock box.

When the Internal Revenue examination of the estate tax return got under way and the examining agent had proceeded with some phases of his inquiry, the executor advised his accountant and his attorney of the existence of the cash in the box and instructed them to inform the agent.

The record contains quantities of detail concerning this cash and the safe deposit box. It leaves little doubt that

the executor knew of this cash, knew it had been his father's, and knowingly failed to include it in the return.

II

The second issue is whether the Commissioner had the burden of proving that some $15,000 in municipal bonds were not reported on the estate tax return or included in the $613,314.52 in cash not reported on the return. The Commissioner's deficiency notice set forth a list of $54,000 in bonds as having been omitted from the estate tax return. Later he conceded error as to all but $15,000 of these bonds. It is the taxpayer's contention that, since there was error in some of the items in the original determination by the Commissioner, the presumption of validity which originally attached to the other items no longer applies. The contention is not tenable. The burden shifts to the Commissioner if the record shows that his original determination was arbitrary and excessive.[1] But the record in this case does not indicate that the Commissioner's determination as to these bonds was arbitrary or excessive. It is undisputed that they belonged to the decedent at his death. The only issue is whether the proceeds from the redemption of these bonds was included in the $613,314.52 of cash not reported on the return. The Tax Court correctly held there was insufficient evidence to trace the proceeds of these bonds to the safe deposit box cash. Under these circumstances the Commissioner's determination that the bonds should have been reported on the return is still presumptively correct.

III

Upon the trial the Government offered in evidence a certified copy of a judgment of conviction entered by a United States District Court against this executor in a

[1] *Durkee* v. *Commissioner of Internal Revenue*, 162 F.2d 184 (6th Cir. 1947).

criminal case based upon the falsity of this estate tax return. The judgment recited that it was "upon his plea of Nolo Contendere." The Tax Court admitted the document "for the purpose of credibility both of the witness and the return and as part of the general background of the case. . . ." The executor says the admission of this evidence was reversible error. We think it was not.

This was not a jury case but was trial by a judge, not likely to be confused as to the purport of these judicial proceedings. The judge pointed out she was not treating this evidence as "in the nature of a judicial admission". She did not refer to it in her discussion of the fraud issue. She relied entirely upon evidence apart from the criminal plea, as she should have done, but the plea and conviction were certainly part of the background material in this complicated set of facts.[2] The executor himself testified in the Tax Court, and the admission of his plea in the criminal case for purposes of impeachment is not disputed. The debate concerns only the additional purpose—as "'background"—recited by the trial court in its ruling.

## IV

The more difficult question in the case concerns the amount of the civil penalty for fraud. Is it one-half the total tax payable on the estate? Or is it one-half the deficiency in the tax as stated on the return? The difference in dollars in this case is great.

The question divides into parts. The first part is: Which statute governs—the so-called 1939 code or the 1954 code? Congress reenacted the Internal Revenue Code in 1954. The new code clearly provided that the penalty for fraud

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[2] *Kilpatrick* v. *Commissioner of Internal Revenue*, 227 F.2d 240, 243-244 (5th Cir. 1955); *A. B. Dick Co.* v. *Marr*, 95 F.Supp. 83, 101 (S.D.N.Y. 1950), *appeal dismissed*, 197 F.2d 498 (2d Cir.), *cert. denied*, 344 U.S. 878 (1952).

in estate tax cases should be 50 per cent of the "underpayment".[3] It was enacted August 16, 1954. Decedent in the case now at bar died May 24, 1954. The effective date of the new law was fragmented among subtitles, chapters, sections, subsections, paragraphs and subparagraphs. However the general affirmations of the new code are that it applied to estates of decedents dying after the date of the new enactment.[4] An analysis in minute detail confirms that impression in respect to the estate tax fraud penalty, which is the only matter here involved. The Tax Court thought the correct view to be that the law in existence when this decedent died, *i.e.*, the 1939 code, was applicable here,[5] and we agree. We pause to detail in a footnote the intricacies of this examination.[6]

We come then to consider what the 1939 code provided in respect to civil penalties for fraud in estate tax cases.

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[3] INT. REV. CODE of 1954, § 6653(b).

[4] *Id.* § 7851(a)(2)(A).

[5] 40 T.C. 100, 123-125 (1963).

[6] The decedent died on May 24, 1954, and the estate tax return was filed on July 21, 1955. The date of enactment of the 1954 code, was, as we have said, August 16, 1954. Section 7851(a)(2)(A) of the new code provided that the estate tax imposed by the 1939 code, subtitle B, chapter 11, should apply to the estates of decedents dying before August 17, 1954, and thus to the estate of the decedent in this case. Section 3612(d)(2) of the 1939 code, which imposes the estate tax civil fraud penalty, is part of subtitle D of the 1939 code. Section 7851(a)(6)(D) of the 1954 code provides that subtitle D of the 1939 code "shall remain in effect with respect to taxes imposed by the Internal Revenue Code of 1939." Since the taxes in this case were imposed by the 1939 code, the addition to tax "with respect to" those taxes, which was imposed by section 3612(d)(2) of the 1939 code, remained in effect. Rev. Rul. 54-427, 1954-2 C.B. 42.

The provision is in Section 3612(d) (2) of that Code.[7] The Tax Court, agreeing with the executor, was of the view that the penalty thus provided was 50 per cent of the understatement in tax. The Government disagrees. It is earnest in insisting that the penalty is 50 per cent of the total tax imposed by the statute upon the estate; *i.e.*, that which is shown on the return plus that which is not thus shown. Thus it is obvious that a problem is posed on the point. We agree with the Government's position.

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[7] The pertinent parts are:

"SEC. 3612. RETURNS EXECUTED BY COMMISSIONER OR COLLECTOR.

(a) AUTHORITY OF COLLECTOR.—If any person fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

(b) AUTHORITY OF COMMISSIONER.—In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise—

(1) TO MAKE RETURN.—Make a return, or

(2) TO AMEND COLLECTOR'S RETURN.—Amend any return made by a collector or deputy collector.

* * * * *

(d) ADDITIONS TO TAX.—

(1) FAILURE TO FILE RETURN.—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, . . .

(2) FRAUD.—In case a false or fraudulent return or list is willfully made, the Commissioner shall add to the tax 50 per centum of its amount.

(3) CROSS REFERENCE.—

For additions to tax in the case of income tax, see sections 291 and 293, and in the case of a deficiency in gift tax, see section 1019."

The solution to the problem of the meaning of this 1939 statute is historical rather than philosophical.[8] Originally, from 1791, all internal federal taxes were "indirect" taxes, "excises"—taxes imposed upon an event or the exercise of a right.[9] They were paid in large part by the affixing of stamps.[10] The constitutional requirement[11] that "direct" taxes be laid "in proportion to the Census" proved to be so cumbersome as to prevent such taxation for long by the Federal Government, although it was tried several times.[12] There were no *ad valorem* penalties for fraudulent returns of these early taxes. Specific dollar amounts of penalties and direct forfeiture of goods (such as distilled spirits and tobacco) on which the tax had not been paid,

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[8] In *New York Trust Co.* v. *Eisner*, 256 U.S. 345, 349 (1921), which held the federal estate tax constitutional, Mr. Justice Holmes wrote, ". . . a page of history is worth a volume of logic."

[9] The first internal taxes enacted in the United States were in the Act of March 3, 1791, ch. 15, 1 STAT. 199. Other revenue acts kept a system of internal taxes in force until 1802. Act of May 8, 1792, ch. 32, 1 STAT. 267; Act of June 5, 1794, ch. 49, 1 STAT. 378; Act of July 6, 1797, ch. 11, 1 STAT. 527; Act of July 9, 1798, ch. 70, 1 STAT. 580. There were no internal taxes from 1802 to 1813. From 1813 until 1817 another system of internal taxes was in force. Act of July 22, 1813, ch. 16, 3 STAT. 22; Act of July 24, 1813, ch. 21, 3 STAT. 35; Act of July 24, 1813, ch. 24, 3 STAT. 40; Act of July 24, 1813, ch. 25, 3 STAT. 42; Act of Aug. 2, 1813, ch. 37, 3 STAT. 53; Act of Dec. 21, 1814, ch. 15, 3 STAT. 152; Act of Apr. 19, 1816, ch. 58, 3 STAT. 291. From 1817 until 1861 there were no internal taxes in the United States.

[10] As on tobacco, etc. Even the first federal death tax was a stamp tax on receipts given for legacies. Act of July 6, 1797, ch. 11, § 1, 1 STAT. 527.

[11] U.S. CONST. art. I, § 9, cl. 4; and art. I, § 2, cl. 3.

[12] *E.g.*, Act of July 9, 1798, ch. 70, 1 STAT. 580; Act of July 22, 1813, ch. 16, 3 STAT. 22; Act of Aug. 2, 1813, ch. 37, 3 STAT. 53; Act of Aug. 5, 1861, ch. 45, 12 STAT. 292.

were simpler and more sensible.[13] Thus it was until the War Between the States necessitated vast increases in federal revenue.

The income tax and the inheritance tax came into the federal system at about the same time, 1861 and 1862.[14] Both of these taxes, as reenacted in 1864, 1865 and 1866,[15] were held to be indirect taxes and constitutional.[16] No *ad valorem* civil penalties were provided in the 1861 and 1862 Acts, but in 1864, the Congress, reenacting the internal tax system, put in a provision that "in case of the return of a false or fraudulent list or valuation, he [the assessor] shall add one hundred per centum to such duty".[17] Although the inheritance tax and income tax were repealed in 1870 and 1872, respectively,[18] this provision for an *ad valorem* civil fraud penalty continued in effect and applied to other internal taxes as a general administrative provision. The provision, as amended,[19] was incorporated into the Second Edition of the Revised States [*sic*] in 1878 as Section 3176. It remained in force as such until incorporated into the 1939 Code as Section 3612(d) (2).

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[13] *E.g.*, Act of March 3, 1791, §§ 27, 28, 32, ch. 15, 1 STAT. 199, 206-207; Act of July 24, 1813, §§ 2, 6, ch. 21, 3 STAT. 35; Act of Dec. 21, 1814, § 6, ch. 25, 3 STAT. 152.

[14] Act of Aug. 5, 1861, ch. 45, 12 STAT. 292 (income tax); Act of July 1, 1862, ch. 119, 12 STAT. 432, 485 (inheritance tax).

[15] Act of June 30, 1864, ch. 173, 13 STAT. 223; Act of March 3, 1865, ch. 78, 13 STAT. 469; Act of July 13, 1866, ch. 184, 14 STAT. 98.

[16] *Scholey* v. *Rew*, 90 U.S. 331 (1874) (inheritance tax); *Springer* v. *United States*, 102 U.S. 586 (1880) (income tax).

[17] Act of June 30, 1864, § 14, ch. 173, 13 STAT. 223, 227.

[18] Act of July 14, 1870, ch. 255, 16 STAT. 256; Act of June 6, 1872, ch. 315, 17 STAT. 230.

[19] Act of March 3, 1865, § 1, ch. 78, 13 STAT. 469; Act of July 13, 1866, § 9, ch. 184, 14 STAT. 101.

The inheritance tax and the later estate tax have always been held to be indirect taxes or excises and on this basis have been held constitutional, even though not apportioned on the basis of the census.[20] But the income tax had a different history. In 1894 Congress again enacted an income tax.[21] And in 1895 the Supreme Court changed its mind about that tax and held it to be a direct tax and unconstitutional because not apportioned according to the census.[22] A constitutional amendment was thus made necessary and was adopted as of February 25, 1913.[23] Thus the income tax, a direct tax not required to be apportioned according to the census, fell into a niche all its own. Congress in 1918 undertook to write complete administrative provisions for the newly conceived income tax. In the 1918 Act it included a provision that the penalty for a false and fraudulent income tax return be an *ad valorem* penalty of 50 per cent of "the deficiency".[24]

Thus the matter stood, the estate tax among the other indirect or excise taxes, administratively under Section 3176 of the Revised Statutes and its counterpart, Section 3612(d) (2) of the 1939 code, and the income tax separate and apart in a category all its own, until the 1954 code was being written. By that time the old distinctions between direct and indirect taxes, so essential to the constitutional validity of taxes in earlier days, had largely

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[20] *Scholey* v. *Rew*, 90 U.S. 331 (1874); *Knowlton* v. *Moore*, 178 U.S. 41, 81 (1900); *New York Trust Co.* v. *Eisner*, 256 U.S. 345 (1921).

[21] Act of Aug. 27, 1894, ch. 349, 28 STAT. 509, 553.

[22] *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), *rehearing*, 158 U.S. 601 (1895).

[23] U.S. CONST. amend. XVI.

[24] Revenue Act of 1918, § 250, ch. 18, 40 STAT. 1057, 1083.

faded from view.[25] More practical notions prevailed. An estate tax looked like an imposition directly upon the property involved, instead of upon the right to transmit or the fact of transmission. At any rate the estate tax and the income tax looked much alike administratively to the Congress in the 1950's. And so the penalties for fraud were made alike. But until then the gulf between indirect taxes as a group and the income tax, separate by amendment, had retained its historical being and significance.

The administrative construction of the penalty provisions is not helpful one way or the other. In 1899 the Commissioner directed[26] that the 100 per cent penalty "is always computed upon the amount actually due over and above that shown to be due by the false return." In 1915 his successor in office held[27] that the 100 per cent penalty imposed for the filing of false or fraudulent returns "applies to the full amount of the tax involved", and he revoked that portion of the 1899 decision which had held to the contrary. Apparently his view was uniformly applied under Section 3176 of the Revised Statutes and Section 3612(d) (2) of the 1939 code until the change made by the 1954 code.

The few scattered court cases which appear in the reports follow the pattern of the administrative decisions, but

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[25] The 1924 gift tax was repealed in 1926; but when it was reenacted in 1932 Congress adapted the income tax fraud penalty to the gift tax rather than incorporate by reference Section 3176 of the Revised Statutes, which was applicable to the estate tax and other taxes and which had been applicable to the 1924 gift tax. Thus the new gift tax penalty was 50 per cent of "the deficiency". Revenue Act of 1932, § 520(b), ch. 209, 47 STAT. 169, 255.

[26] T.D. 21517, 2 TREAS. DEC. INT. REV. 281 (1899).

[27] T.D. 2266, 17 TREAS. DEC. INT. REV. 263 (1915). See also Treas. Reg. 46 § 316.205(e) (1940); Treas. Reg. 43 § 101.44(e) (1941); Treas. Reg. 42 § 130.79(e) (1942); Treas. Reg. 113 § 143.62 (1943); Treas. Reg. 51 § 320.77(e) (1920); Treas. Reg. 119 § 324.46(e) (1953); Treas. Reg. 59 § 323.49 (1921).

either the measure of the penalty was not litigated or the conclusion was "no fraud".[28] So these cases are of little authoritative purport in the pending problem.

The textbooks state the matter clearly and succinctly,[29] and they state the rule as we have found it to be.

The executor says that Section 3612 of the 1939 code—the whole section—deals with returns made out by the Commissioner or a collector (when the taxpayer files no return or files a false one) and that when subsection (d) of that section speaks of "the tax" it means the additional tax shown by the Commissioner. This seems to us to be at best a strained construction. The subsection (*i.e.*, (d)) says that in case of fraud the Commissioner "shall add to the tax 50 per centum of its amount." These words are not obscure in their meaning. Indeed, in the immediately preceding sentence the statute treats of additions to the tax in the case of a failure to file a return on time, and it there provides that "the Commissioner shall add to the tax 25 per centum of its amount". The words obviously

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[28] Pre-1915 cases: *Doll* v. *Evans*, 7 Fed. Cas. 855 (No. 3969) (C.C.E.D. Pa. 1872); *Michigan Cent. R. Co.* v. *Slack*, 17 Fed. Cas. 262 (No. 9527) (C.C.D. Mass. 1873); *German Sav. Bank* v. *Archbold*, 10 Fed. Cas. 260 (No. 5364) (C.C.S.D.N.Y. 1878), *reversed*, 104 U.S. 708 (1879).

Post-1915 cases: *Beam* v. *Hamilton*, 289 Fed. 9 (6th Cir. 1923); John H. Collinson, 1 B.T.A. 561 (1925); F. W. Lukins, 3 B.T.A. 204 (1925); Joy D. (Lockwood) Wills, 9 P-H B.T.A. Mem. 51 (1940); *Stiles* v. *United States*, 58-2 U.S.T.C. 69,931 (S.D. Fla. 1958); *Estate of Schneller*, 28 P-H Tax Ct. Mem. 570 (1959); Estate of Lottie Hamar, 29 P-H Tax Ct. Mem. 643 (1960).

[29] P-H Fed. Tax Serv. 42-43 (1919); Montgomery, Income Tax Procedure 135 (1922); Montgomery, Income Tax Procedure 171 (1924); Montgomery, Income Tax Procedure, Vol. I, p. 220 (1926); Montgomery, Federal Tax Practice 202 (1929); Montgomery, Federal Tax Handbook 706 (1932); Montgomery, Federal Tax Handbook 820 (1933-34); Montgomery, Federal Tax Handbook 858 (1934-35); Balter, Fraud Under Federal Tax Law 121 (1951 ed.).

refer to the whole tax, there being no deficiency less than the whole.[30] So the same words in the next sentence in the statute would seem to have the same meaning.

The plain fact of the matter is that Congress wrote an entire treatment of the income tax when that tax was carved out of the melange of federal revenue provisions, but until 1954 it left the estate tax with the other indirect, or excise, taxes. This latter treatment accorded with the historical concepts of such taxes. In the 1939 code the penalty for a false income tax return was prescribed as a percentage of "the deficiency" (Sec. 293(b)); the penalty for false returns of indirect, or excise, taxes generally (Sec. 3612) was a percentage of "the tax". The difference, as our study shows, was not due to inadvertence, carelessness, or lack of understanding. It was the result of long, slow, not illogical development in the law. Concepts had by that time reached a certain stage in their legislative development. Later they moved further in the direction of similarity. But it is not for the courts to anticipate such later developments, or to guess what Congress might have done had it not done what it did. Change in existing statutory provisions is for the legislature. We think the courts must apply the statutory terms as they existed on the critical date in a given case.

We are told that this is a case of first impression. To eyes and ears in the 1960's it seems strange that this should be so. But upon examination several explanatory features appear. Usually the person who must make the return (the executor) has only a small interest dependent upon the amount of the estate; his in-pocket gleaning from fraud is not worth the potential criminal risks. Also estate tax returns are fewer in number, and usually estate taxes of notable amount receive penetrating attention from the authorities. These are anti-fraud factors. On the other

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[30] *American Milk Products Corp.* v. *United States*, 41 F.2d 966 (Ct.Cl. 1930).

hand it also appears that the courts have been reluctant to find fraud in these cases, as the cases cited in our note 28, *supra,* show. At any rate we are presented, so far as we can ascertain, with a problem as to which we have no guiding casebook authority.

V

The judgment of the Tax Court must be set aside and the case remanded to that court for a computation and imposition of a civil fraud penalty in accordance with this opinion. In all other respects the judgment and decision of the Tax Court is affirmed.

So ordered.

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## APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 15,653

COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

v.

ESTATE OF HARRY STOLL LEYMAN, Deceased,
HARRY S. LEYMAN, JR., *Executor,*
*Respondent.*

**On Petition to Review a Decision of the Tax Court of the United States**

BEFORE: PHILLIPS and EDWARDS, Circuit Judges, and PRETTYMAN, Senior Circuit Judge.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby set aside and the case remanded for a computation and imposition of a civil fraud penalty in accordance with the opinion. In all other respects the decision of the Tax Court is affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
*Clerk*

Filed: March 29, 1965

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## APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 15,732

ESTATE OF HARRY STOLL LEYMAN, Deceased,
HARRY S. LEYMAN, JR., *Executor*,
*Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

**On Petition to Review a Decision of the Tax Court of the United States**

BEFORE: PHILLIPS and EDWARDS, Circuit Judges, and PRETTYMAN, Senior Circuit Judge.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby set aside

and the case remanded for a computation and imposition of a civil fraud penalty in accordance with the opinion. In all other respects the decision of the Tax Court is affirmed.

No costs awarded. Rule 23(4).

Entered by order of the Court.

/s/ CARL W. REUSS
*Clerk*

Filed: March 29, 1965

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## APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 15,653

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*
v.
ESTATE OF HARRY STOLL LEYMAN, Deceased,
HARRY S. LEYMAN, JR., *Executor,*
*Respondent.*

**Order Denying Petition for Rehearing**

BEFORE: PHILLIPS and EDWARDS, Circuit Judges, and PRETTYMAN, Senior Circuit Judge.*

Upon consideration, it is ORDERED that the petition for rehearing be and hereby is denied.

Entered by order of the Court.

/s/ CARL W. REUSS
*Clerk*

Filed: April 27, 1965

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* Sitting by designation from the District of Columbia Circuit.

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